

STATE OF HAWAII
DEPARTMENT OF LABOR AND
INDUSTRIAL RELATIONS
WORKERS' COMPENSATION SPECIAL
COMPENSATION FUND

FINANCIAL STATEMENTS AND FORECAST

June 30, 2005 and 2004



CONSULTANTS

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Mr. Nelson Befitel
Director, State of Hawaii
Department of Labor and Industrial Relations

We have audited the statements of assets, liability and fund balances arising from cash transactions of the State of Hawaii, Department of Labor and Industrial Relations, Workers' Compensation Special Compensation Fund as of June 30, 2005 and June 30, 2004 and the related statements of revenues collected and expenses paid and changes in fund balances-unreserved for the years then ended. These financial statements are the responsibility of the Workers' Compensation Special Compensation Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audit in accordance with U.S. generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

As described in Note 2, these financial statements were prepared on the cash receipts and disbursements basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the assets, liabilities and fund balances arising from cash transactions of the State of Hawaii, Department of Labor and Industrial Relations, Workers' Compensation Special Compensation Fund as of June 30, 2005 and June 30, 2004, and its revenues collected and expenses paid and changes in fund balances-unreserved for the years then ended, on the basis of accounting described in Note 2.

ONTS CPA, LLP

Honolulu, Hawaii
January 10, 2006

STATE OF HAWAII
DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
WORKERS' COMPENSATION SPECIAL COMPENSATION FUND
Statements of Assets, Liability and Fund Balances - Cash Basis
June 30, 2005 and 2004

ASSETS

	<u>2005</u>	<u>2004</u>
Cash		
Held in State Treasury	\$21,640,931	\$22,774,926
Receivables		
Overpayment of benefits to claimants	346,577	275,739
Non-compliant employers	<u>4,685,310</u>	<u>3,882,300</u>
	5,031,887	4,158,039
Less: allowance for doubtful accounts	<u>(4,972,000)</u>	<u>(4,021,000)</u>
	<u>59,887</u>	<u>137,039</u>
	<u>\$21,700,818</u>	<u>\$22,911,965</u>

LIABILITY AND FUND BALANCES

Liability		
Security deposit from self-insured employer	<u>\$ 1,000,000</u>	<u>\$ 1,000,000</u>
	<u>1,000,000</u>	<u>1,000,000</u>
Fund Balances		
Reserved for receivables	59,887	137,039
Unreserved	<u>20,640,931</u>	<u>21,774,926</u>
	<u>20,700,818</u>	<u>22,911,965</u>
	<u>\$21,700,818</u>	<u>\$22,911,965</u>

The accompanying notes are an integral
part of the financial statements.

STATE OF HAWAII
DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
WORKERS' COMPENSATION SPECIAL COMPENSATION FUND
Statements of Revenues Collected and Expenses Paid
and Changes in Fund Balances-Unreserved - Cash Basis
Years Ended June 30, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Revenues Collected		
Levy on insurance carriers and self-insured employers	\$15,299,875	\$18,096,814
Interest income	596,534	569,927
Penalties for non-compliance	56,243	33,688
Other (including reimbursements of overpayment of benefits by claimants of \$32,298 and \$28,006, in 2005 and 2004, respectively)	32,420	50,312
Defaulting employers reimbursement	19,150	81,621
No dependency and non-work connected death cases	<u>7,526</u>	<u>96,930</u>
	<u>16,011,748</u>	<u>18,929,292</u>
Expenses Paid		
Workers' compensation payments		
Benefit adjustment	8,083,345	10,811,440
Secondary injury provision	6,126,765	6,130,469
Defaulting employers	1,013,454	868,373
Concurrent employment	581,121	673,338
Total disability	337,961	356,960
Services of attendant and vocational rehabilitation	<u>119,792</u>	<u>110,745</u>
	16,262,438	18,951,325
Other expenses		
Inter/intra-department/agency reimbursed costs		
Attorney general's and other costs	612,598	528,530
Facilitator unit	154,786	146,617
Administrative support	109,991	90,673
Audit fee	<u>5,930</u>	<u>11,500</u>
	<u>17,145,743</u>	<u>19,728,645</u>

The accompanying notes are an integral part of the financial statements.

STATE OF HAWAII
DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
WORKERS' COMPENSATION SPECIAL COMPENSATION FUND
Statements of Revenues Collected and Expenses Paid
and Changes in Fund Balances-Unreserved - Cash Basis
Years Ended June 30, 2005 and 2004
(continued)

	<u>2005</u>	<u>2004</u>
Deficiency of Revenues		
Collected Over Expenses Paid	(1,133,995)	(799,353)
Fund Balances, unreserved at beginning of year	<u>21,774,926</u>	<u>22,574,279</u>
Fund Balances, unreserved at end of year	<u>\$20,640,931</u>	<u>\$21,774,926</u>

The accompanying notes are an integral
part of the financial statements.

STATE OF HAWAII
DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
WORKERS' COMPENSATION SPECIAL COMPENSATION FUND
Notes to Financial Statements - Cash Basis
Years Ended June 30, 2005 and 2004

1. Organization

The Workers' Compensation Special Compensation Fund (Fund) was created under Chapter 386, Section 151 of the Hawaii Revised Statutes (as amended) to allow each injured party an opportunity to receive disability benefits as provided by the State statutes. The Director of Finance of the State was custodian of the Fund and the Director of Labor and Industrial Relations was the administrator.

Under Sections 152-154 of Chapter 386 of the Hawaii Revised Statutes, the Fund was authorized to levy and collect assessments in amounts sufficient to meet the Fund's current and projected obligations. Section 153 provides for a levy assessed on insurers of employers, which was determined by the Director of Labor and Industrial Relations based on a percentage of gross premiums on workers' compensation policies. Section 154 authorized the Director of Labor and Industrial Relations to assess employers who maintain self-insured workers' compensation plans.

2. Summary of Significant Accounting Policies

a. Basis of Accounting

The Fund's policy was to prepare its financial statements on the cash receipts and disbursements basis of accounting. Under this basis, revenues were recognized when collected rather than when earned, and expenses were recognized when paid rather than when incurred. Consequently, penalty receivables, benefits payable to claimants, and accrued litigation fees payable at June 30, 2005 and 2004 were not included in the financial statements.

STATE OF HAWAII
DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
WORKERS' COMPENSATION SPECIAL COMPENSATION FUND
Notes to Financial Statements - Cash Basis
Years Ended June 30, 2005 and 2004

b. Receivables

Receivables were recorded for financial statement presentation purposes and occurred when claimant benefit payments were made by the Fund on behalf of non-compliant employers, to deceased claimants and to claimants whose benefits were decreased through court or Department of Labor and Industrial Relations decisions. The allowance for uncollectible receivables was recognized as a reduction in receivables and accordingly, the net receivables were reported in Fund balance - reserved for receivables.

3. Interest Income

Effective August 1, 1999, the Fund participated in the State Treasury Investment Pool System of the State of Hawaii. The cash held in State Treasury was included in the investment pool system and was under the direction of the Director of Finance. The interest earned on pool investments was computed monthly by the Financial Administration Division of the Department of Budget and Finance using an interest rate (approximately 3% per annum) applied to the monthly cash balance. The credit risk on the cash held in State Treasury was determined at the State level and not by the Fund.

4. Commitments

The Fund was liable to pay workers' compensation benefits to claimants over the period of their disability. Estimated annual benefits payable to claimants were \$20,500,000 and \$18,900,000 in the fiscal year ending June 30, 2006 and the fiscal year ended June 30, 2005, respectively. The liabilities were based on commitments as of June 30, 2005 and 2004, and did not include benefits, which may result from cases presently on appeal.



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Mr. Nelson Befitel
Director, State of Hawaii
Department of Labor and Industrial Relations

We have compiled the accompanying forecasted schedule of cash balance and levy of assessments - cash basis of the State of Hawaii, Department of Labor and Industrial Relations, Workers' Compensation Special Compensation Fund for the period from August 1, 2005 through March 31, 2007 in accordance with attestation established by the American Institute of Certified Public Accountants.

The accompanying forecasted schedule presents, to the best of the Workers' Compensation Special Compensation Fund management's knowledge and belief, the cash balance and levy of assessments - cash basis of the State of Hawaii, Department of Labor and Industrial Relations, Workers' Compensation Special Compensation Fund for the forecasted period. It is not intended to be a forecast of financial position or results of operations. The accompanying forecasted information and this report were prepared for the State of Hawaii, Department of Labor and Industrial Relations, Workers' Compensation Special Compensation Fund for the purpose of providing a basis from which to assess levies on insurance carriers and self-insured employers.

A compilation is limited to presenting forecasted information that is the representation of the Workers' Compensation Special Compensation Fund's management and does not include evaluation of the support for the assumptions underlying such information. We have not examined the forecasted schedule and, accordingly, do not express an opinion or any other form of assurance on the accompanying schedule or assumptions. Furthermore, there will usually be differences between the forecasted and

actual results, because events and circumstances frequently do not occur as expected, and those differences may be material. We have no responsibility to update this report for events and circumstances occurring after the date of this report.

The accompanying forecasted schedule and this report are intended solely for the information and use of the State of Hawaii, Department of Labor and Industrial Relations, Workers' Compensation Special Compensation Fund and insurance carriers and self-insured employers and are not intended to be and should not be used by anyone other than the specified parties.

ONTS CPA, LLP

Honolulu, Hawaii
January 10, 2006

STATE OF HAWAII
DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
WORKERS' COMPENSATION SPECIAL COMPENSATION FUND
Forecasted Schedule of Cash Balance and Levy of Assessments - Cash Basis (rounded to nearest thousand)
For the Twenty-Month Period from August 1, 2005 through March 31, 2007

	2005		2006							
	August	September	October	November	December	January	February	March	April	May
Forecasted cash balance - beginning of month	\$20,634	\$18,862	\$20,591	\$20,908	\$20,199	\$19,011	\$17,156	\$15,881	\$20,136	\$18,858
Revenues:										
Levy of insurance carriers and self-insured employers	236	2,847	1,083	493				10,050		
Interest income	50	56	55	34	35	34	32	28	27	33
Other	32	2	25							
Total Forecasted Cash Balance and Revenues Before Expenses	<u>20,952</u>	<u>21,767</u>	<u>21,754</u>	<u>21,435</u>	<u>20,234</u>	<u>19,045</u>	<u>17,188</u>	<u>25,959</u>	<u>20,163</u>	<u>18,891</u>
Expenses:										
Workers' Compensation Payments:										
Benefit adjustment	981	485	445	536	536	1,124	557	5,057	536	536
Secondary injury	883	465	83	450	450	500	500	500	500	500
Defaulting employers	70	91	120	46	46	51	51	51	46	46
Total disability	55	28	1	30	30	30	30	30	30	30
Other	64	86	54	20	20	20	20	20	44	44
Other Expenses:										
Inter/intra-department reimbursed costs/others	37	21	143	154	141	164	149	165	149	149
Total Forecasted Expenses	<u>2,090</u>	<u>1,176</u>	<u>846</u>	<u>1,236</u>	<u>1,223</u>	<u>1,889</u>	<u>1,307</u>	<u>5,823</u>	<u>1,305</u>	<u>1,305</u>
Forecasted cash balance - end of month	<u>\$18,862</u>	<u>\$20,591</u>	<u>\$20,908</u>	<u>\$20,199</u>	<u>\$19,011</u>	<u>\$17,156</u>	<u>\$15,881</u>	<u>\$20,136</u>	<u>\$18,858</u>	<u>\$17,586</u>
Levy of assessments:										
Self-insured employers		\$ 4,659								
Insurance carriers								\$10,050		

See summary of significant assumptions and accounting policies and accountants' compilation report.

Forecasted Schedule of Cash Balance and Levy of Assessments - Cash Basis (rounded to nearest thousand)
For the Twenty-Month Period from August 1, 2005 through March 31, 2007

(1) Does not include additional levy assessment due from insurance carriers in March 2007.

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STATE OF HAWAII
DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
WORKERS' COMPENSATION SPECIAL COMPENSATION FUND
Summary of Significant Assumptions and Accounting
Policies - Cash Basis for the Period from
August 1, 2005 through March 31, 2007

1. Nature of Presentation

The accompanying forecasted schedule of cash balance and levy of assessments presents, to the best of the Workers' Compensation Special Compensation Fund management's knowledge and belief, the Fund's expected December 31 cash balance and levy of assessments for the forecasted period. Accordingly, the presentation reflects its judgment as of January 10, 2006, the date of this presentation, of the expected conditions and its expected course of action. The assumptions disclosed herein are those that the Workers' Compensation Special Compensation Fund management believes are significant to the presentation. There will usually be differences between the forecasted and actual results, because events and circumstances frequently do not occur as expected, and those differences may be material. The accompanying presentation and this report were prepared for the Fund's use in assessing levies on insurance carriers and self-insured employers and should not be used for any other purpose.

2. Basis of Accounting

The accompanying forecasted schedule has been prepared on the cash receipts and disbursements basis of accounting, which differs from generally accepted accounting principles.

3. Levy on Insurance Carriers and Self-Insured Employers

The forecasted assessment on insurance carriers was based on a 3.0% levy on an estimated \$335,000,000 of gross premiums to be written in 2005. The estimate of gross premium was based on management's knowledge and belief. The self-insured employers' assessment for September 2006, was based on 29% of the total levies to be assessed in 2006.

STATE OF HAWAII
DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
WORKERS' COMPENSATION SPECIAL COMPENSATION FUND
Summary of Significant Assumptions and Accounting
Policies - Cash Basis for the Period from
August 1, 2005 through March 31, 2007

4. Interest Income

Effective August 1, 1999, the Fund participates in the State Treasury Investment Pool System of the State of Hawaii. The interest earned on pool investments is computed monthly by the Financial Administration Division of the Department of Budget and Finance using an interest rate (2% per annum for the forecasted schedule) applied to the monthly cash balance.

5. Workers' Compensation Payments

Expenses were estimated based on trend analysis of past financial data to provide for new cases and increases in disability payments. This payment, authorized by Hawaii Revised Statutes section 386-35, provides economic relief to permanently totally-disabled claimants.

In 1982, legislation was passed to provide for an increase in workers' compensation benefit adjustment payments every ten years. Effective January 1, 2002, the benefit adjustment payments increased from \$437 to \$564. For the forecasted schedule of cash balance and levy of assessments - cash basis, the increase in benefit adjustment payments is estimated to be a 10% increase for new claims and a projected reimbursement to insurance carriers of approximately \$4,500,000 in March 2006.

6. Inter/Intra-Department/Agency Reimbursed Costs

The attorney general's reimbursed costs are forecasted at approximately \$123,000 per month. Other facilitator unit and administrative support reimbursed costs are forecasted at approximately \$26,000 per month.